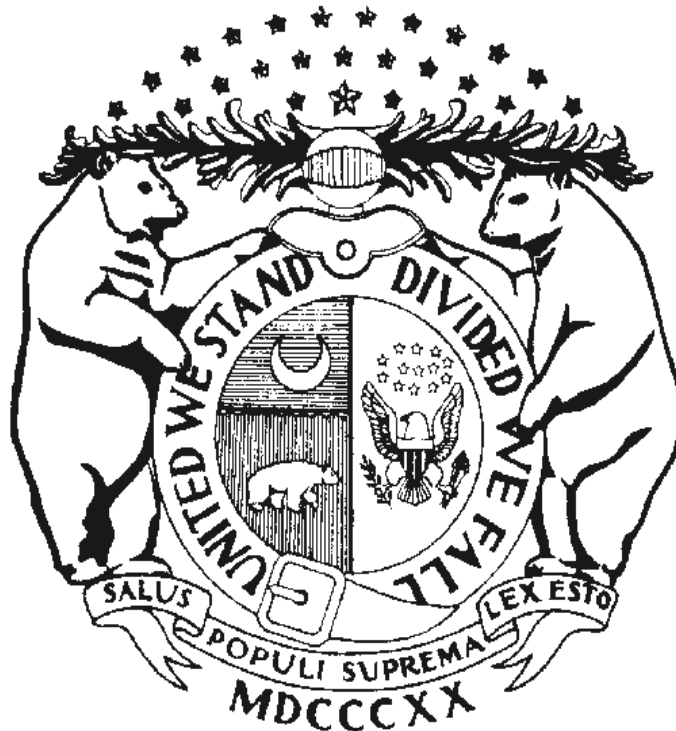


**REPORT OF THE  
ASSOCIATION FINANCIAL EXAMINATION OF  
SHELTER REINSURANCE COMPANY**

**AS OF  
DECEMBER 31, 2001**



**STATE OF MISSOURI  
DEPARTMENT OF INSURANCE  
JEFFERSON CITY, MISSOURI**

## TABLE OF CONTENTS

<b>SCOPE OF EXAMINATION .....</b>	<b>1</b>
PERIOD COVERED .....	1
PROCEDURES .....	2
COMMENTS - PREVIOUS EXAMINATION .....	3
<b>HISTORY .....</b>	<b>4</b>
GENERAL .....	4
CAPITAL STOCK .....	4
DIVIDENDS .....	4
MANAGEMENT .....	5
COMMITTEES .....	6
OFFICERS .....	6
CONFLICT OF INTEREST .....	7
CORPORATE RECORDS .....	7
ACQUISITIONS, MERGERS AND MAJOR CORPORATE EVENTS .....	7
SURPLUS DEBENTURES .....	7
<b>AFFILIATED COMPANIES .....</b>	<b>8</b>
HOLDING COMPANY, SUBSIDIARIES AND AFFILIATES .....	8
ORGANIZATIONAL CHART .....	10
INTERCOMPANY AGREEMENTS .....	11
INTERCOMPANY PAYMENTS .....	12
<b>FIDELITY BOND AND OTHER INSURANCE .....</b>	<b>13</b>
<b>PENSION, STOCK OWNERSHIP AND INSURANCE PLANS.....</b>	<b>13</b>
<b>STATUTORY AND OTHER DEPOSITS.....</b>	<b>14</b>
DEPOSITS WITH THE STATE OF MISSOURI .....	14

DEPOSITS WITH OTHER STATES.....	14
OTHER DEPOSITS .....	14
<b>INSURANCE PRODUCTS AND RELATED PRACTICES.....</b>	<b>15</b>
TERRITORY AND PLAN OF OPERATION .....	15
POLICY FORMS & UNDERWRITING;.....	15
ADVERTISING & SALES; .....	15
TREATMENT OF POLICYHOLDERS.....	15
<b>REINSURANCE .....</b>	<b>16</b>
GENERAL .....	16
ASSUMED .....	16
CEDED .....	19
<b>ACCOUNTS AND RECORDS.....</b>	<b>20</b>
GENERAL .....	20
<b>FINANCIAL STATEMENTS.....</b>	<b>20</b>
ASSETS.....	21
LIABILITIES, SURPLUS AND OTHER FUNDS .....	22
STATEMENT OF INCOME .....	23
<b>NOTES TO THE FINANCIAL STATEMENTS.....</b>	<b>24</b>
<b>EXAMINATION CHANGES .....</b>	<b>26</b>
<b>GENERAL COMMENTS AND/OR RECOMMENDATIONS .....</b>	<b>27</b>
<b>ACKNOWLEDGMENT .....</b>	<b>28</b>
<b>VERIFICATION.....</b>	<b>28</b>
<b>SUPERVISION .....</b>	<b>28</b>

Columbia, Missouri  
September 17, 2003

Chairman of Financial Condition (EX4) Subcommittee  
Southeastern Zone Secretary  
Honorable Alfred W. Gross, Commissioner  
Virginia Bureau of Insurance

Midwestern Zone Secretary  
Jim Poolman, Commissioner  
North Dakota Department of Insurance

Honorable Scott B. Lakin, Director  
Missouri Department of Insurance  
301 West High Street, Room 530  
Jefferson City, Missouri 65101

Gentlemen:

In accordance with your financial examination warrant, a full scope association financial examination has been made of the records, affairs and financial condition of

**Shelter Reinsurance Company**

hereinafter referred to as such, as Shelter Reinsurance, or as the Company. Its administrative office is located at 1817 West Broadway, Columbia, Missouri 65218, telephone number 573-445-8441. This examination began on November 4, 2002, and concluded on the above date.

**SCOPE OF EXAMINATION**

**Period Covered**

The prior full scope association financial examination of Shelter Reinsurance was made as of December 31, 1998, and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC), with no other zones participating.

The current full scope association financial examination covered the period from January 1, 1999, through December 31, 2001, and was conducted by examiners from the State of Missouri, representing the Midwestern Zone of the NAIC, with no other zones participating.

This examination was conducted concurrently with the examinations of the Company's parent, Shelter Mutual Insurance Company (Shelter Mutual), and its affiliates, Shelter General Insurance Company (Shelter General), and Shelter Life Insurance Company (Shelter Life). Shelter Mutual and its insurance subsidiaries are collectively referred to as the Shelter Insurance Companies in this report.

This examination also included the material transactions and/or events occurring subsequent to the examination date, which are noted in this report.

### **Procedures**

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the NAIC, except where practices, procedures and applicable regulations of the Missouri Department of Insurance (MDI) and statutes of the State of Missouri prevailed.

The examiners relied upon information supplied by the Company's independent auditor, PriceWaterhouseCoopers, LLP, of St. Louis, Missouri, for its audit covering the period from January 1, 2001, through December 31, 2001. Information relied upon included attorney letters, tests of controls, and narrative descriptions of processes and controls.

### **Comments - Previous Examination**

The previous financial examination of Shelter Reinsurance was conducted by the MDI for the period ending December 31, 1998. Listed below are the comments, recommendations, and notes from the previous examination report, the Company's response, and the findings in the current examination.

#### **Fidelity Bond**

*Comment:* It was recommended that the Company should obtain a minimum of \$700,000 of fidelity coverage to cover employees for dishonest acts in the normal course of business as recommended by the NAIC guidelines for the protection of its assets.

*Company's Response:* The Company stated that the fidelity bond coverage had been obtained as recommended.

*Current Findings:* The Company currently has a financial institution bond that provides fidelity coverage in excess of the minimum level recommended by the guidelines of the NAIC. Refer to the Fidelity Bond and Other Insurance section of this report for further details.

#### **Reinsurance**

*Comment:* It was noted that the 1987 intercompany retrocession agreement lacked an insolvency clause, which is required by Missouri Regulation 20 CSR 200-2.100 (11)(A) (Credit for Reinsurance). It was recommended that the Company should review its reinsurance agreements to make sure that all agreements have insolvency clauses, which comply with the cited regulation.

*Company's Response:* The Company stated that its ceded reinsurance contracts had been reviewed and changes were being made to have them conform with Missouri Regulation 20 CSR 200-2.100 (11)(A).

*Current Findings:* No problems were found with the insolvency clauses in the Company's reinsurance agreements that were reviewed during the examination.

## **Accounts and Records**

*Comment:* It was recommended that the Company should maintain claim files for the year in which the claim is closed plus three calendar years, in accordance with Section 374.205 RSMo (Examination of Insurers).

*Company's Response:* The Company stated that its retention policy and practices were revised to conform with Section 374.205 RSMo.

*Current Findings:* No problems were noted in the retention of claim files.

## **HISTORY**

### **General**

Shelter Reinsurance was incorporated on October 6, 1986. It was issued a Certificate of Authority and commenced business on November 24, 1986. The Company operates as a stock property and casualty reinsurer under the insurance laws of Chapter 379 RSMo (Insurance Other Than Life).

### **Capital Stock**

Shelter Reinsurance is owned 100% by Shelter Mutual. The Company is authorized to issue 15,000,000 shares of common stock with a par value of \$1 per share. As of December 31, 2001, all 15,000,000 shares were issued and outstanding for a total capital stock balance of \$15,000,000.

### **Dividends**

No dividends or cash distributions were paid or declared during the examination period.

## Management

The management of the Company is vested in a Board of Directors that are appointed by the sole shareholder, Shelter Mutual. The Company's Articles of Incorporation and Bylaws specify that the number of directors shall be nine. The Board of Directors appointed and serving, as of December 31, 2001, were as follows:

<u>Name and Address</u>	<u>Principal Occupation and Business Affiliation</u>
James A. Offutt Osage Beach, MO	Chairman, Retired Executive Shelter Insurance Companies
Robert W. Maupin% Columbia, MO	Vice Chairman, Retired Executive Shelter Insurance Companies
Raymond E. Jones Columbia, MO	Secretary and Executive Vice President Shelter Insurance Companies
H. Marshall Chatfield Columbia, MO	Retired Executive Kansas City Life Insurance Company
Ann K. Covington Columbia, MO	Attorney / Partner Bryan Cave, LLP
John D. Duello Rocheport, MO	President and Chief Executive Officer Shelter Insurance Companies
Andres Jimenez Madrid, Spain	Vice President and Chief Executive Officer MAPFRE Re Compania de Reaseguros, S.A.
John W. Lenox* Columbia, MO	Retired Executive Shelter Insurance Companies
Barry L. McKuin Morrlilton, AR	President Morrlilton Area Chamber of Commerce

\* Mr. Lenox died in November 2002 and was replaced by Don A. McCubbin in April 2003  
% Mr. Maupin retired in April 2003 and was replaced by Dr. Gerald Brouder in May 2003



## **Committees**

The Bylaws require an Executive and Compensation Committee and an Audit Committee of the Board of Directors. The Bylaws also allow for other committees to be appointed by the Board of Directors as needed. An Investment Committee was in operation during and subsequent to the examination period. As of December 31, 2001, the members of each committee were as follows:

### Executive and Compensation Committee

Robert W. Maupin, Chairman  
J. Donald Duello  
H. Marshall Chatfield  
James A. Offutt  
Ann K. Covington

### Audit Committee

Barry L. McKuin, Chairman  
Ann K. Covington  
H. Marshall Chatfield

### Investment Committee

J. Donald Duello, Chairman  
Raymond E. Jones  
Thomas Fischer  
John W. Lenox  
Robert W. Maupin  
James A. Offutt  
H. Marshall Chatfield

## **Officers**

The officers elected by the Board of Directors and serving as of December 31, 2001, were as follows:

John D. Duello	President and Chief Executive Officer
Raymond E. Jones	Executive Vice President and Secretary
Robert T. Cox #	Executive Vice President and General Counsel
Don A. McCubbin	Executive Vice President
Jerry L. French	Vice President, Treasurer and Assistant Secretary
Thomas N. Fischer	Vice President – Investments
Gary D. Myers @	Vice President – Administration

# Robert T. Cox resigned effective March 1, 2002 and was replaced by Randa C. Rawlins on April 15, 2002. Ms. Rawlins was elected as General Counsel only.

@ Gary D. Myers was elected Executive Vice President on April 3, 2002.  
Max T. Dills elected to replace Mr. Myers as Vice President – Administration.

**Conflict of Interest**

The Company has a policy that requires all officers, directors, and key employees to complete a conflict of interest statement each year. Signed statements of officers and directors were reviewed for the examination period. No significant exceptions were noted.

**Corporate Records**

A review was made of the Articles of Incorporation and Bylaws for the examination period. There were no amendments or changes to the Articles of Incorporation during the period under examination. The Bylaws were amended in April 2001 to require an Audit Committee to be maintained.

The minutes of the Board of Directors' meetings, committee meetings, and stockholders' meetings were reviewed for proper approval of corporate transactions. In general, the minutes appear to properly reflect and approve the Company's major transactions and events for the period under examination.

**Acquisitions, Mergers and Major Corporate Events**

None.

**Surplus Debentures**

No surplus debentures were issued or outstanding for the period under examination.

## AFFILIATED COMPANIES

### Holding Company, Subsidiaries and Affiliates

The Company is a member of an Insurance Holding Company System as defined by Section 382.010, RSMo (Definitions). An Insurance Holding Company System Registration Statement was filed by the parent, Shelter Mutual, on behalf of itself, Shelter Reinsurance, and its other insurance subsidiaries, for each year of the examination period.

Shelter Mutual, a property and casualty insurer, does not have any stockholders or controlling entity due to its formation as a mutual entity. The Company is ultimately owned by the policyholders of Shelter Mutual. Affiliated insurers that are also owned 100% by Shelter Mutual include Shelter General, a property and casualty insurer, and Shelter Life, a life insurance company.

The following subsidiaries are owned 100% by Shelter Reinsurance, unless specified otherwise:

**Shelter (UK) Holdings, Ltd.** – A holding company for Shelter Dedicated, Ltd. and Commodore Underwriting Agencies, Ltd.

**Shelter Dedicated, Ltd.** – A Lloyd's of London corporate member that accepts risks for a Lloyd's syndicate. Accepted risks for the policy year from January 1, 2001 through December 31, 2001. Due to the poor experience, no other risks were accepted after 2001. The company is now in run-off with a three-year accounting period ending December 31, 2003.

**Commodore Underwriting Agencies, Ltd. (Commodore)** – An underwriter for risks taken by Shelter Dedicated, Ltd and other Lloyd's syndicates. As of the first quarter of 2003, the entity has no operations, employees, or significant assets.

**Shelter Enterprises, LLC** – This is a small entity (only \$6.1 million of total assets) that owns property and equipment and derives its income from leasing the assets to affiliates, including Shelter Mutual. Owned 10% by Shelter Reinsurance.

The operations of the Company's other affiliates are described as follows:

**Shelter Financial Services, Inc. (SFS)** – A holding company for Shelter Benefits Management, Inc.

**Shelter Benefits Management, Inc. (Shelter Benefits)** – Provides the human resource function and manages agent and employee benefits for the Shelter Insurance Companies.

**Shelter Financial Corporation (SFC)** – A holding company for Shelter Bank.

**Shelter Bank** – A savings and loan company that sells certificates of deposits, individual retirement accounts, and provides auto loans and mortgage loans. It does not have any demand accounts (checking or savings). Its customers are mainly policyholders of Shelter Mutual and Shelter General, but customers may also come from the general public.

**Daniel Boone Underwriters, LLC** – An insurance broker that places risks from leads generated by agents of the Shelter Insurance Companies. The risks placed are in lines of business that are not written by Shelter Mutual or Shelter General.

**Daniel Boone Agency, Inc.** – An insurance broker in the same manner as explained for Daniel Boone Underwriters, LLC above, except that this entity operates in Illinois only.

**DBU, Inc.** – An insurance broker in the same manner as explained for Daniel Boone Underwriters, LLC above, except that this entity operates in Mississippi only.

# Organizational Chart

The following table depicts Shelter Reinsurance's ownership and holding company system, as of December 31, 2001:

<u>Company</u>	<u>Parent or Controlling Entity</u>	<u>Ownership</u>
Shelter Mutual Insurance Company	Policyholders	100%
Shelter General Insurance Company	Shelter Mutual Insurance Company	100%
Shelter Enterprises, LLC	Shelter General Insurance Company	45%
	Shelter Life Insurance Company	45%
	Shelter Reinsurance Company	10%
Shelter Life Insurance Company	Shelter Mutual Insurance Company	100%
<b>Shelter Reinsurance Company</b>	Shelter Mutual Insurance Company	100%
Shelter (UK) Holdings, Ltd.	Shelter Reinsurance Company	100%
Shelter Dedicated, Ltd.	Shelter (UK) Holdings, Ltd.	100%
Commodore UW Agencies, Ltd.	Shelter (UK) Holdings, Ltd.	100%
Shelter Financial Corporation	Shelter Mutual Insurance Company	100%
Shelter Bank	Shelter Financial Corporation	100%
Shelter Financial Services, Inc.	Shelter Mutual Insurance Company	79.5%
	Shelter General Insurance Company	11%
	Shelter Life Insurance Company	9.5%
Shelter Benefits Management, Inc.	Shelter Financial Services, Inc.	100%
Daniel Boone Underwriters, LLC	Shelter Mutual Insurance Company	40%
	Shelter General Insurance Company	40%
	Shelter Life Insurance Company	20%
Daniel Boone Agency, Inc.	Daniel Boone Underwriters, LLC	100%
DBU, Inc.	Daniel Boone Underwriters, LLC	100%

### **Intercompany Agreements**

The Company's intercompany agreements in effect, as of December 31, 2001, are outlined below.

**1. Type:** Agreement for Management Services and Facilities

**Affiliates:** Shelter Mutual

**Effective:** January 1, 1997

**Terms:** Shelter Mutual agrees to provide the employees to operate all aspects of Shelter Reinsurance. Services to be provided include recordkeeping, processing, planning, budgeting, receipt and disbursement activities, and all work incidental to the operation of the Shelter Reinsurance's business. Shelter Mutual agrees to provide office space, utilities, computer systems, office equipment, and supplies. In exchange for the services and facilities provided by Shelter Mutual, Shelter Reinsurance will make monthly payments to Shelter Mutual. Payments will be calculated in accordance with the Joint Expense Allocation Agreement between Shelter Mutual and the Subsidiaries.

**2. Type:** Joint Expense Allocation Agreement

**Affiliates:** Shelter Mutual, Shelter General, Shelter Life, SFS, Daniel Boone Underwriters, LLC, Shelter Enterprises, LLC, Daniel Boone Agency, Inc., DBU, Inc., Shelter Benefits

**Effective:** May 19, 1999

**Terms:** Each party agrees to pay its direct expenses in instances when each entity's actual usage can be determined. The parties agree to allocate any joint expenses for instances in which the identification and segregation of each entity's actual share is not practically feasible. The allocation methodologies for each category of joint expenses are as follows:

- (1) Personnel – estimated or actual time
- (2) Real Estate – square footage and employee count
- (3) Investment – portfolio value
- (4) Claims Adjustment (applicable to Shelter Mutual and Shelter General only) – incurred losses
- (5) Other Expenses – assets, employee count, or written premium

**3. Type:** Tax Allocation Agreement

**Affiliates:** Shelter Mutual, Shelter General, Shelter Life, SFS, SFC, Shelter Benefits, Shelter Bank

**Effective:** No stated effective date. Applicable to 1999 and subsequent tax years.

**Terms:** Shelter Mutual will file a consolidated federal income tax return on behalf of itself and its subsidiaries. The tax liability for each company will be the amount that would have been determined on a separate filing basis. The subsidiaries will pay their share of tax payments to Shelter Mutual within 10 days following any tax payments made by Shelter Mutual. Shelter Mutual will refund any amount due to the subsidiaries within 10 days after filing the consolidated return.

Shelter Reinsurance is a named insured on a general liability insurance policy issued by Shelter Mutual. The policy insures the premises and operations of the Shelter Mutual and all named insureds. Premium for this policy is charged to Shelter Reinsurance through intercompany allocations under the Joint Expense Allocation Agreement.

Shelter Reinsurance provides earth movement coverage on all real and personal property at locations owned or used by Shelter Mutual. Premium is paid directly to Shelter Reinsurance upon receipt of renewal notice.

**Intercompany Payments**

The following table summarizes the payments made during the exam period, between Shelter Reinsurance and its affiliates.

Affiliate	Agreement or Transaction	Net Paid / (Received)		
		1999	2000	2001
Shelter Mutual	Joint Expense Allocation	\$1,014,104	\$943,669	\$1,016,295
Shelter Mutual	Tax Allocation	(637,828)	206,397	(1,208,576)
Shelter Mutual	Sale of MAPFRE Re stock	0	0	(2,450,814)
<b>TOTAL</b>		<u>\$376,276</u>	<u>\$1,150,066</u>	<u>(\$2,643,095)</u>

## **FIDELITY BOND AND OTHER INSURANCE**

The Shelter Insurance Companies are named insureds on a financial institution bond. The bond provides employee fidelity coverage with a liability limit of \$2,500,000 and a \$50,000 deductible. This level of coverage complies with the suggested minimum amount of fidelity insurance according to NAIC guidelines.

The Shelter Insurance Companies are also named insureds on the following insurance policies: property, general liability, umbrella excess liability, automobile physical damage and liability, aircraft physical damage and liability, workers compensation and employers liability, computer crime, kidnap and ransom / extortion, and earth movement.

## **PENSION, STOCK OWNERSHIP AND INSURANCE PLANS**

Shelter Reinsurance does not have any direct employees or agents. Employees of the parent, Shelter Mutual, perform all functions necessary for the operation of Shelter Reinsurance, pursuant to the Agreement for Management Services and Facilities. Shelter Reinsurance reimburses Shelter Mutual for an allocated share of the payroll and benefits costs of the employees that provide services, pursuant to a Joint Expense Allocation Agreement. Both agreements are described further in the Intercompany Agreements section of this report.

A variety of standard benefits are provided to the Shelter Mutual employees. These benefits include, but are not limited to, the following: medical insurance, dental insurance, life insurance, personal accident insurance, disability insurance, sick leave, and tuition reimbursement. Employees are also provided with a defined benefit pension plan and a 401(k) savings and profit sharing plan. Certain highly compensated employees are provided with a Supplemental Employee Retirement Plan (SERP).



**STATUTORY AND OTHER DEPOSITS****Deposits with the State of Missouri**

The funds on deposit with the Missouri Department of Insurance as of December 31, 2001, were sufficient to meet the capital deposit requirements for the State of Missouri in accordance with Section 379.098 RSMo (Securities Deposit). The funds on deposit as of December 31, 2001, were as follows:

<u>Type of Security</u>	<u>Par Value</u>	<u>Fair Value</u>	<u>Statement Value</u>
Municipal and State Bonds	\$2,000,000	\$2,097,090	\$2,019,092

**Deposits with Other States**

The Company did not have any funds on deposit with other states, as of December 31, 2001.

**Other Deposits**

The Company has pledged assets to Brown Brothers Harriman as collateral for letters of credit relating to its participation in a Lloyd's of London syndicate. The pledged assets consisted of U.S. government bonds with par values of \$7,750,000, as of December 31, 2001.

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

### **Territory and Plan of Operation**

The Company is licensed for the business of property and casualty insurance in the State of Missouri under Chapter 379 RSMo. The Company is also licensed, but does not write any direct business in the following states: Iowa, Kansas, Maryland, and Michigan. In addition, the Company is either registered or licensed as a reinsurer in Argentina, Chile, Colombia, France, Mexico, Paraguay, Peru, Puerto Rico, and Venezuela.

The Company is primarily a reinsurer with over 99% of its premiums being reinsurance assumed. Approximately 43% of the assumed premiums come from the Company's parent, Shelter Mutual Insurance Company, which retrocedes most of its assumed reinsurance to Shelter Reinsurance.

The majority of the reinsurance business the Company assumes is property catastrophe coverage. The Company assumes reinsurance business from all over the world with the largest concentrations being from the United States, the United Kingdom, and Japan. Business is acquired through a combination of direct contact with ceding companies and the use of brokers.

### **Policy Forms & Underwriting;** **Advertising & Sales;** **Treatment of Policyholders**

The Missouri Department of Insurance has a market conduct staff, which performs a review of these issues and generates a separate market conduct report. Since the Company is primarily a reinsurer with only a minimal volume of direct business, a market conduct examination for the Company has not been performed.

**REINSURANCE****General**

The Company's premium activity on a direct written, assumed and ceded basis, for the period under examination, is detailed below:

	<u>1999</u>	<u>2000</u>	<u>2001</u>
Direct Business	\$ 10,000	\$ 5,000	\$ 5,000
Reinsurance Assumed:	0	0	0
Affiliates	19,613,921	32,585,869	29,223,077
Non-affiliates	24,650,468	36,946,767	39,387,528
Reinsurance Ceded:			
Affiliates	0	0	0
Non-affiliates	<u>(548,738)</u>	<u>(608,838)</u>	<u>(1,285,545)</u>
<b>Net Premiums Written</b>	<b><u>\$43,725,651</u></b>	<b><u>\$68,928,798</u></b>	<b><u>\$67,330,060</u></b>

**Assumed**

Shelter Reinsurance Company was formed in 1986 to manage the reinsurance business assumed by its parent, Shelter Mutual Insurance Company, and to expand the reinsurance book of business written by the Shelter Companies. Shelter Reinsurance is a professional reinsurer with numerous reinsurance agreements. All of the Company's business is assumed reinsurance except for one small direct policy, which is issued to Shelter Mutual.

Shelter Reinsurance has an intercompany retrocession agreement, effective January 1, 1987, with Shelter Mutual, in which Shelter Mutual acts as a fronting company for Shelter Reinsurance. Pursuant to this agreement, Shelter Reinsurance assumes 100% of the risks from Shelter Mutual's entire book of assumed business, except for business from involuntary pools and Lloyd's Syndicate No. 529. Almost half of the business assumed by Shelter Reinsurance is through this fronting arrangement with Shelter Mutual.

The remaining reinsurance business was assumed from approximately 300 individual insurance companies located throughout the world. The Company assumed 55% of non-affiliated premiums in 2001 from the following six companies: Assurance of France Aviation, Cox Power Services, D.P. Mann Esq., Kiln Underwriting Limited, Transatlantic Re, and MAPFRE Re. These six companies also accounted for 38% of total non-affiliated, assumed loss reserves, as of December 31, 2001. The agreements with these companies are described as follows.

The Company has a quota share agreement with Assurance France Aviation (AFA), effective January 1, 2000, to assume aviation risks. The agreement applies to covered aircraft risks up to a maximum limit of \$165,000,000 per risk and occurrence. AFA cedes 30% of its insured risks to several reinsurers. Shelter Reinsurance has a 1.75% participation share in the 30% that is ceded.

The Company has a quota share agreement, effective January 1, 1999, with Cox Power Services (CPS), which is an underwriter in the Lloyd's market. CPS underwrites for Lloyds Syndicate No. 1208, which specializes in insuring electrical companies. CPS cedes 90% of its business underwritten through the Lloyds Syndicate to various reinsurers. Shelter Reinsurance has a 6% participation share in the 90% that is ceded. The maximum amounts subject to reinsurance are \$5,000,000 per risk and \$15,000,000 per occurrence. This agreement was terminated effective March 31, 2000, and is in run off.

Shelter Reinsurance has a quota share agreement, effective January 1, 1998, with D.P. Mann Esq. (D.P. Mann), an underwriter for Lloyd's Syndicate No. 435. Pursuant to this agreement, D.P. Mann cedes 5% of its property pro rata, risk excess of loss, and catastrophe lines of business to Shelter Reinsurance. The maximum losses subject to reinsurance are \$40,000,000

per contract with an overall maximum of \$250,000,000 for losses related any one occurrence. Therefore, the Company's limit of liability is \$2,000,000 per contract and \$12,500,000 per occurrence.

The Company has a quota share agreement, effective January 1, 2000, with Kiln Underwriting Limited, which is an underwriter for various Lloyd's Syndicates. Under this agreement, Kiln Underwriting Limited cedes 16% of its property business written through the Lloyds Syndicates to Shelter Reinsurance. Shelter Reinsurance's total maximum liability limit, as stated in the agreement, was 16% of £69,000,000, which translates to approximately \$15,940,000 at December 31, 2001 exchange rates.

The Company has a property, facultative, quota share agreement with Transatlantic Reinsurance Company (Transatlantic), effective July 1, 2001, to assume property risks located in Latin America and the Caribbean territories. Transatlantic cedes 50% of risks, up to a maximum of \$7,000,000 per risk, to various reinsurers. Shelter Reinsurance has a 25% participation share in the 50% that is ceded. The maximum risks that are covered by the agreement are \$7,000,000 per risk and \$20,000,000 aggregate for Latin America business and \$10,000,000 aggregate for Caribbean business.

The Company has a quota share retrocession program with MAPFRE Re. The program is comprised of five separate treaties all effective January 1, 2001. Under the treaties, MAPFRE Re retrocedes 3.5% of its fire proportional, marine proportional, fire and engineering facultative, marine facultative and engineering business to Shelter Re. There maximum losses subject to reinsurance vary between the five agreements. Shelter Reinsurance's 3.5% share of the maximum assumed risks totals approximately \$3,600,000 for all of the agreements.

The Company has another quota share reinsurance agreement with MAPFRE Re, effective January 1, 2001, to assume risks from a pool of companies that cede business to a reinsurance pool. This agreement applies to the 2001 calendar year. The risk amounts subject to reinsurance vary greatly between cedant and line of business and are defined in schedules that are part of the agreement. The maximum risk for a single line of business is approximately 4.2 million Euros. Shelter Reinsurance's participation shares vary from a minimum of 7.1% and a maximum of 9.342%.

### **Ceded**

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer fails to perform its obligations under the reinsurance agreement.

Shelter Reinsurance has limited ceded reinsurance activity. Total ceded loss reserves were only \$1,596,000, as of December 31, 2001. The Company cedes a small portion of aviation business to Navigators Insurance Company, accounting for \$1,486,000 or 93% of ceded loss reserves, as of December 31, 2001.

## ACCOUNTS AND RECORDS

### General

The CPA firm, PricewaterhouseCoopers, LLP, of St. Louis, Missouri, issued audited statutory financial statements of the Company for all years in the examination period.

The reserves for losses and loss adjustment expenses were reviewed and certified by Terrence M. O'Brien, FCAS, MAAA, CPCU for all years in the examination period. Mr. O'Brien is employed by PricewaterhouseCoopers, LLP, of Chicago, Illinois.

## FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of Shelter Reinsurance for the period ending December 31, 2001. Any examination adjustments to the amounts reported in the financial statements and/or comments regarding such are made in the "Notes to the Financial Statements." The failure of any column of numbers to add to its respective total is due to rounding or truncation.

There may have been additional differences found in the course of this examination, which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial concerning their effect on the financial statements, and therefore, were only communicated to the Company and noted in the workpapers for each individual Annual Statement item.

## Assets as of December 31, 2001

	<u>Assets</u>	Non-Admitted <u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$142,286,070	\$ 0	\$142,286,070
Common Stocks	581,658	0	581,658
Cash and Short-term Investments	12,334,540	0	12,334,540
Other Invested Assets	607,000	0	607,000
Agents' Bal. or Uncollected Premiums ( <b>Note 1</b> )	20,820,321	4,208,239	16,612,082
Funds Held by or Deposited with Reins. Co.'s	3,296,729	0	3,296,729
Reinsurance Recoverables on Losses and LAE	15,617	0	15,617
Federal Income Tax Recoverable	6,578,931	3,119,991	3,458,940
Investment Income Due and Accrued	2,368,565	0	2,368,565
Net Adjust. Due to Foreign Exchange Rates	3,761,073	0	3,761,073
Receivable from Parent, Sub., and Affiliates	8,287	0	8,287
Agg. Write-Ins for Other than Invested Assets:			
Miscellaneous Accounts Receivable	<u>114,011</u>	<u>0</u>	<u>114,011</u>
<b>TOTAL ASSETS</b>	<b><u>\$192,772,802</u></b>	<b><u>\$7,328,230</u></b>	<b><u>\$185,444,572</u></b>



## Liabilities, Surplus and Other Funds as of December 31, 2001

Losses ( <b>Note 2</b> )	\$100,428,418
Reinsurance Payable on Paid Loss and LAE	14,449,830
Loss Adjustment Expenses	964,016
Commissions Payable	1,261,504
Other Expenses	38,779
Unearned Premiums	12,734,301
Ceded Reinsurance Premiums Payable	140,489
Payable to Parent, Subsidiaries and Affiliates	115,250
Aggregate Write-Ins for Liabilities:	
Premium Deficiency Reserve	<u>482,350</u>
<b>TOTAL LIABILITIES</b>	<b>\$130,614,937</b>
Common Capital Stock	15,000,000
Gross Paid In and Contributed Surplus	20,000,000
Unassigned Funds (Surplus)	<u>19,829,636</u>
Surplus as Regards Policyholders	<u><b>\$54,829,636</b></u>
<b>TOTAL LIABILITIES AND SURPLUS</b>	<b><u><u>\$185,444,573</u></u></b>

## Statement of Income

### For the Year Ended December 31, 2001

<b>Premium Earned</b>	<b>\$64,146,086</b>
<b>DEDUCTIONS:</b>	
Losses Incurred	52,817,691
Loss Expenses Incurred	1,167,477
Other Underwriting Expenses Incurred	20,419,787
Aggregate Write-Ins for Underwriting Deductions	<u>482,350</u>
<b>Total Underwriting Deductions</b>	<b><u>\$74,887,305</u></b>
<b>Net Underwriting Loss</b>	<b>(\$10,741,219)</b>
 Net Investment Income Earned	 8,394,559
Net Realized Capital Losses	<u>(1,233,624)</u>
<b>Net Investment Gain</b>	<b>\$ 7,160,935</b>
 Other Income	 (98,061)
Federal Income Taxes Incurred	<u>(1,204,301)</u>
 <b>Net Income</b>	 <b><u>(\$ 2,474,044)</u></b>
 <b>CAPITAL AND SURPLUS ACCOUNT:</b>	
Surplus as Regards Policyholders, December 31, 2000	\$58,778,738
Net Income	(2,474,044)
Net Unrealized Capital Gains or (Losses)	1,440,255
Change in Net Deferred Income Tax	(509,174)
Change in Non-Admitted Assets	(6,131)
Cumulative Effect of Changes in Accounting Principle	5,642,993
Aggregate Write-Ins for Gains and Losses in Surplus:	
Change in Foreign Exchange Adjustment	1,310,743
Examination Changes	<u>(9,353,744)</u>
<b>Surplus as Regards Policyholders, December 31, 2001</b>	<b><u>\$54,829,636</u></b>

## Notes to the Financial Statements

**Note 1 – Agents Balances or Uncollected Premiums****\$16,612,082**

Assumed premium receivables of \$7,098,000 from Kiln Underwriting, Ltd. were reported on Schedule F - Part 1 (Assumed Reinsurance). This is a net amount that includes premiums receivable, unearned premiums, commissions payable, and other items. SSAP No. 64 (Offsetting and Netting of Assets and Liabilities) allows for these items to be shown as one net amount. However, also included in the net amount is a deferred acquisition cost (DAC) asset of \$2,741,661. DAC assets are not specified as admitted assets in the Accounting Practices and Procedures Manual, and therefore, should have been extracted from the net amount and non-admitted. In the future, the Company should ensure to properly non-admit DAC assets that are reported in the Kiln ceding statements and reported in any other assumed reinsurance balances.

Paragraph 36 of SSAP No. 62 (Property and Casualty Reinsurance) states that assumed premiums receivable more than 90 days past due may be admitted to the extent that (a) the reporting company maintains assumed unearned premium and loss reserves for the ceding entity or (b) where the ceding entity is licensed and in good standing in the assuming entity's state of domicile. Any premiums receivable over 90 days that do not comply with this criteria should be non-admitted. The Company provided a aging spreadsheet for premiums receivable as reported on the Premiums and Agents' Balances in Course of Collection line. It was found that the Shelter Reinsurance had premiums receivable over 90 days past due from alien ceding companies that were not offset by unearned premium or loss reserves. These amounts totaled \$1,358,083 and should have been non-admitted, pursuant to SSAP No. 62, paragraph 36. The

Company should ensure to properly non-admit assumed premiums receivable amounts over 90 days past due in the future, in accordance with SSAP No. 62.

Examination changes were made to non-admit the DAC assets and premium receivables over 90 days past due, as described above.

**Note 2 – Losses**

**\$100,428,418**

MDI's consulting actuary, Expert Actuarial Services, LLC, determined that Shelter Reinsurance's loss reserves were deficient, as of December 31, 2001. The deficiency was determined by reviewing the development of incurred losses in 2002 and the first half of 2003. Loss reserves would need to be increased by \$5,254,000, as of December 31, 2001, to be within a reasonable range. An examination change was made to increase loss reserves by this amount. The reserve deficiency does not appear to be due to any failures in the Company's actuarial methods or assumptions.

## Examination Changes

Capital and Surplus Per Company, December 31, 2001:

Common Capital Stock	\$15,000,000
Gross Paid In and Contributed Surplus	20,000,000
Unassigned Funds (Surplus)	<u>29,183,380</u>
<b>Total Capital and Surplus</b>	<b>\$64,183,380</b>

Examination Changes:

Non-Admit Deferred Acquisition Costs ( <b>Note 1</b> )	(2,741,661)
Non-Admit Past Due Premiums Receivable ( <b>Note 1</b> )	(1,358,083)
Increase Loss Reserves for Deficiency ( <b>Note 2</b> )	<u>(5,254,000)</u>
<b>Total Examination Changes</b>	<b>(\$9,353,744)</b>

Capital and Surplus Per Examination, December 31, 2001:

Common Stock	\$15,000,000
Gross Paid-in and Contributed Surplus	20,000,000
Unassigned Funds	<u>19,829,636</u>
<b>Total Capital and Surplus</b>	<b><u>\$54,829,636</u></b>

## **General Comments and/or Recommendations**

### **Premiums Receivable (page 24)**

A deferred acquisition cost (DAC) asset of \$2,741,661 was netted into the premiums receivable that were reported from Kiln Underwriting, Ltd (Kiln). DAC assets are not specified as admitted assets in the Accounting Practices and Procedures Manual, and therefore, should have been extracted from the net amount and non-admitted. In the future, the Company should ensure to properly non-admit DAC assets that are reported in the Kiln ceding statements and reported in any other assumed reinsurance balances.

Shelter Reinsurance had premiums receivable over 90 days past due from alien ceding companies that were not offset by unearned premium or loss reserves. These amounts totaled \$1,358,083 and should have been non-admitted, pursuant to SSAP No. 62, paragraph 36. The Company should ensure to properly non-admit assumed premiums receivable amounts over 90 days past due in the future, in accordance with SSAP No. 62.

### ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and the employees of Shelter Reinsurance Company during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Shawn Hernandez, CFE, Shannon Schmoeger, CFE, Steve Koonse, CFE, Mark Nance, CFE, Andy Balas, CFE, Barbara Bartlett, CPA, and James Smith, examiners for the Missouri Department of Insurance, also participated in this examination. The firm of Expert Actuarial Services, LLC, participated as a consulting actuary.

### VERIFICATION

State of Missouri                 )  
  )  
County of                         )

I, Tim L. Tunks, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of Shelter Reinsurance Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

\_\_\_\_\_  
Tim L. Tunks, CPA, CFE  
Examiner-In-Charge  
Missouri Department of Insurance

Sworn to and subscribed before me this \_\_\_\_\_ day of \_\_\_\_\_, 2003.

My commission expires: \_\_\_\_\_  
Notary Public

### SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

\_\_\_\_\_  
Frederick G. Heese, CFE, CPA  
Audit Manager  
Missouri Department of Insurance